Better Procedures Are Needed to Ensure Lien Payoff Letters Are Properly Authorized and Accurately Calculated

June 2002

Reference Number: 2002-10-105

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

June 10, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Better Procedures Are Needed to Ensure Lien Payoff Letters Are Properly Authorized and Accurately Calculated (Audit # 200110041)

This report presents the results of our review of the Internal Revenue Service's (IRS) lien payoff letters. The overall objectives of this review were to determine if the IRS' lien payoff letters listed the proper amount needed to release the Notice of Federal Tax Lien and if the IRS had authorization from taxpayers before providing the lien payoff letters to third parties (title companies and escrow agents).

In summary, we found that the processing of lien payoff letter requests was not adequate to ensure that taxpayers authorized the release of tax account information and that accurate lien payoff amounts were provided. For 71 percent of the lien payoff letters we reviewed, there was no indication in the case files that the taxpayer gave the necessary authorization to the IRS. Moreover, lien payoff records were not always retained for the period of time required by disclosure guidelines. In addition, the amounts needed to release a federal tax lien were sometimes misstated on lien payoff letters. For 16 percent of the lien payoff letters reviewed, the lien payoff amounts were overstated because they included tax periods that were not on the tax lien.

We recommended that the IRS develop comprehensive procedures for processing lien payoff letters and incorporate these procedures into the Internal Revenue Manual. We also recommended that lien payoff letter requests be tracked on a national inventory system to control the cases as well as ensure compliance with case retention requirements.

Management's Response: IRS management agreed with our recommendations and is taking appropriate corrective actions. The corrective actions planned include revising the Internal Revenue Manual, developing a standard lien payoff letter, and requesting a future enhancement for an existing automated system to be able to track lien payoff letters. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: IRS management's response stated that the report does not distinguish between lien payoff requests that require taxpayer authorization and those specified in the Internal Revenue Code[1] as "parties of interest." We are aware that taxpayers are not required to authorize the disclosure of a lien payoff balance if a "party of interest" (e.g., lender or mortgage holder) contacts the IRS. We did consider this during our review, and our audit results included only those requests from third parties that did require authorization from the taxpayer. We discussed our methodology and the overall audit results with IRS management during this review.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

[1] Internal Revenue Code § 6103 (k)(2) (2001).

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Background

This audit focused on the Internal Revenue Service's (IRS) lien payoff letter program. We initiated this review based upon a referral from the Treasury Inspector General for Tax Administration's (TIGTA) Office of Investigations. The referral identified one IRS office that was overstating the amount needed to release Federal Tax Liens when issuing lien payoff letters to third parties, such as escrow agents and title companies.

If a taxpayer does not pay his or her taxes, the IRS may file a Notice of Federal Tax Lien (NFTL).[1] The NFTL is a document that the IRS files with a county clerk and recorder or a secretary of state to protect the government's interest in collecting the proper amount of tax revenues. An NFTL is a powerful tax enforcement tool because it attaches to all of the taxpayer's property and any property he or she acquires in the future. The IRS filed approximately 288,000 NFTLs in Fiscal Year 2000.

Generally, when a taxpayer wants to sell real property encumbered by an NFTL, an escrow agent or title company contacts the IRS to find out the payoff amount needed to release the NFTL to clear the title to the property. Before the IRS can provide this information to a third party, it must have taxpayer authorization to release the tax information.[2]

The lien payoff letter should show only the tax periods with outstanding tax liabilities that are covered by an NFTL in the county of sale. For example, if a taxpayer had balances due on Tax Years (TY) 1998 and 1999 but the IRS filed an NFTL for only TY 1998, the lien payoff letter should include only the balance due for TY 1998 because there is no lien attached to TY 1999.

We conducted the audit at five IRS offices (Atlanta, Dallas, Los Angeles, Pittsburgh, and Seattle) during the period October 2001 to January 2002 in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in

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[1] Internal Revenue Code (I.R.C.) § 6323(f) (2001).

[2] I.R.C. § 6103 (2001) protects the privacy of taxpayer information.

Appendix I. Major contributors to the report are listed in Appendix II.

Lien Payoff Information May Have Been Disclosed to Third Parties Without Taxpayer Authorization

A taxpayer's lien payoff information is protected from disclosure by the I.R.C.,[3] and the IRS may not release it to a third party without taxpayer authorization. Treasury Regulations allow the IRS to secure either a written or telephonic consent from the taxpayer to disclose lien payoff information to a third party.[4] Taxpayers may submit a Tax Information Authorization (Form 8821) or they may give verbal consent by telephone or in person. The IRS' procedures regarding disclosure of tax information require the IRS to keep a file with documentation of who authorized the disclosure. To comply with this requirement, IRS employees should keep documentation of either the written or verbal consent. We determined that in 517 of the 732 lien payoff letters (71 percent) we reviewed, there was no indication in the case files that the taxpayer gave such authorization to the IRS.

On August 21, 2001, the IRS issued a memorandum (Interim Guidance on Disclosure of Lien Balance Due Information) to clarify the procedures for third parties, including title and escrow companies, who request a taxpayer's lien payoff balance. This memorandum provides procedures employees should follow to protect against unauthorized disclosures when responding to requests from third parties. The procedures used before August 2001 did not properly classify escrow agents and title companies as third parties. The IRS considered them to be a party that was willing to pay the taxes owed on behalf of the taxpayer rather than only an agent that disburses funds after a sale. As such, the IRS did not require these entities to submit taxpayer authorization with the lien payoff request. If the IRS did not have taxpayer authorization and provided lien payoff information to these third parties, it could violate the taxpayer's privacy rights.

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[3] I.R.C. § 6103 (c) (2001).

[4] Temporary Treas. Reg. § 301.6103 (c)-1T (2001).

The August 2001 memorandum outlined the steps employees should follow when providing a taxpayer's lien payoff balance to third parties, such as escrow agents and title companies. Although the IRS issued new procedures, employees continued to provide lien payoff letters to third parties without documentation of proper authorization from the taxpayer. From our sample of 732 lien payoff letters, the IRS processed 194 lien payoff letters after the August 2001 memorandum. Of these 194 lien payoff letters, we found 129 lien payoff letters (66 percent error rate) still lacked documentation of taxpayer authorization in the case files.

Of the five sites we reviewed, IRS officials at three of those sites stated that they did not receive the memorandum, and a fourth site received it 3 weeks late. The fifth site had the procedures but did not follow them in many cases. None of the five sites we visited had desk procedures for its employees to follow for lien payoff letters, and they did not provide training on the proper procedures for releasing information to third parties.

Because the law provides for civil and criminal penalties for unauthorized disclosures, it is important for the IRS to document that the taxpayer gave authorization before it releases tax information.[5]

Lien Payoff Requests Were Not Always Retained as Required and Not Tracked on an Inventory System

While there is no national procedure that specifically addresses how long lien payoff letters should be maintained in the files, to comply with disclosure guidelines in the Internal Revenue Manual (IRM), the IRS should retain lien payoff records for at least 1 year from the end of the processing year.[6] (Records could be maintained up to 2 years, depending on the time of year the IRS issued the lien payoff letter). The August 2001 memorandum did not specifically address the need to retain these records.

[5] I.R.C. § 7213 (2001) provides that the willful unauthorized disclosure of tax information is a felony. I.R.C. § 7213A (2001) provides that the unauthorized inspection of tax information is a misdemeanor.

[6] IRM 1.3 Exhibit 1-2, Records Control Schedule 1.3 (4/28/99).

The five IRS sites we reviewed did not retain lien payoff letters for a consistent period of time. IRS officials in these locations informed us the retention period ranged from 6 to 12 months. However, when we visited certain offices, we did not always find that records had been retained as indicated. For example, at one site, employees stated that lien payoff letter files were generally not being retained. As a result, although there were 6 employees processing lien payoff letters in the unit, there were only 151 letters that had been retained for the 1-year period.

Because lien payoff letters have not always been consistently retained, the IRS does not have the ability to determine if lien payoff requests were properly processed. This is particularly important if taxpayers file claims for unauthorized disclosures, if taxpayers receive an incorrect payoff amount, or if there is a question about how timely the IRS released an NFTL. In addition, because taxpayers have a right to review their records, the IRS should retain documents in accordance with disclosure laws (including the Freedom of Information Act).[7] Moreover, IRS management has no means to evaluate the quality of service, case processing, and overall unit efficiency if lien payoff letters are not retained.

The IRS does not currently track or control lien payoff letter requests on an inventory system. Instead, the IRS maintains paper files in the area offices. As a result, the IRS does not know how many lien payoff requests are received or how quickly they are worked. The IRS also cannot readily identify cases that have reached the 1-year retention period because the cases are filed by the taxpayer, not by the received date.

An inventory system would enable IRS management to conduct case reviews to measure timeliness of case processing and ensure that unauthorized disclosures are not made to third parties. The IRS could also establish accountability over the lien payoff letter program and have a useful tool to measure overall effectiveness and compliance with the law.

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[7] 5 U.S.C. § 552 (1994 & Supp. IV 1998).

The Amounts Needed to Release a Federal Tax Lien Were Sometimes Misstated on Lien Payoff Letters

Taxpayers or third parties contact the IRS to find out the amount needed to release the NFTL (once the payment is received, the IRS issues a document, Certificate of Release of Federal Tax Lien, which releases the NFTL). By law,[8] the IRS cannot release an NFTL unless one of following three conditions exists:

- The tax liability associated with the NFTL is satisfied.
- The IRS accepts a bond.
- The collection statute of limitations has expired.

Therefore, if the taxpayer intends to pay the amount needed to release an NFTL, it is important that the IRS provide an accurate payoff amount. The balance shown on a lien payoff letter should represent only the amount needed to release the NFTL filed with a county clerk and recorder or a secretary of state. The IRS is required to release a lien within 30 days after the taxpayer satisfies the liability on the NFTL.

Some lien payoff letters overstated the amount needed to release liens

We reviewed the 732 lien payoff letters issued to third parties to determine if the IRS listed the proper payoff amounts to release an NFTL. Based on our comparison of the balances shown on the lien payoff letters to the balances owed on accounts covered by NFTLs, 118 of the 732 (16 percent) letters overstated the amount needed to release the NFTLs for a total of approximately $1.5 million. The average overstatement was $12,400 per letter. We were unable to estimate the total number of overstated lien payoff letters nationally because the IRS does not have an inventory system to track the number of letters issued. The following table shows the results of the sites we reviewed:

[8] I.R.C. § 6325(a) (2001) – Release of Lien or Discharge of Property.

Overstatements Involving Third Party Requests

IRS Site	Cases Reviewed Involving Third Parties	Number of Cases with Over-statements	Percent of Cases with Overstated Payoff Amounts	Amount Overstated (Rounded)
Site 1	93	1	1%	$18,000
Site 2	100	19	19%	$276,000
Site 3	206	78	38%	$1,022,000
Site 4	177	5	3%	$27,000
Site 5	156	15	10%	$121,000
TOTAL	**732**	**118**	**16%**	**$1,464,000**

Source: TIGTA Audit Results.

Generally, the taxpayers owed the total tax liability shown on the lien payoff letter; however, not all the tax periods with unpaid tax liabilities were covered by an NFTL. Consequently, the overstatement was related to the amount needed to release the NFTL, not of the total tax due. By including those tax periods without NFTLs, the lien payoff letters inflated the amount taxpayers needed to pay to release the NFTL.

To comply with the requirements for releasing a lien, the lien payoff letter should clearly state the amount a taxpayer, escrow agent, or title company should pay to obtain a release of the NFTL. We found several reasons why IRS offices overstated the lien payoff letter amounts. For example, one IRS office routinely listed all of a taxpayer's outstanding balances on the lien payoff letter, regardless of whether the tax period was covered by an NFTL. Also, some lien payoff letters were overstated due to math errors, some included taxes owed by other family members, and others included balances from NFTLs filed in counties other than the location of the real property being sold.

The IRS has developed a pro-forma lien payoff letter; however, management at the area offices can modify the format or develop a customized letter. Each of the five area offices we reviewed used different versions of the lien payoff letter. Additionally, three of the sites used a lien payoff letter that listed a lump sum needed to release the NFTL and did not specify the amount owed for each tax period. If the taxpayer owes on multiple tax periods but the NFTL does not cover all periods, it would not be possible to tell which tax periods were covered by an NFTL. As a result, some of the lien payoff letters were misleading because they did not clearly distinguish between the tax periods and balances that were covered by an NFTL and those that were not covered.

An official at one IRS site stated that balances due for all tax periods (even those without an NFTL) are included on lien payoff letters because the tax is owed and should be collected at the same time. The IRS may also be including these balances because there is no longer an effective method of collecting from the proceeds of the sale of property.

Before the passage of the IRS Restructuring and Reform Act of 1998 (RRA 98),[9] the IRS could collect amounts from the sale of property, even if there was no NFTL, by levying the proceeds of the sale. A levy is different from an NFTL and is a legal seizure of a taxpayer's property to satisfy a tax debt. However, the RRA 98 requires the IRS to notify taxpayers of the intent to levy and requires that a period of time be provided for taxpayers to appeal the levy.[10] This makes it impractical in most cases for the IRS to levy the proceeds of a sale.

Furthermore, there are several potential problems that could arise from overstating the balance on lien payoff letters. This practice could burden taxpayers and harm innocent third parties during a sale of real property. An overstated lien payoff letter could cause the sale to fall through if the proceeds from the sale do not satisfy the overstated amount on the lien payoff letter but would have satisfied the amount

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[9] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5.U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

[10] I.R.C. § 6330 (2001).

covered by the NFTL. In these cases, the IRS is prevented from releasing the NFTL. If this occurs, the IRS could lose revenue it would have obtained from the escrow company if the sale transaction had been completed. Taxpayers could be harmed because the tax periods listed on the NFTL could have been paid and they could have obtained a release of the NFTL if the lien payoff letter had been accurate.

In addition, if the sale proceeds would have exceeded the correct lien payoff amount, any third party lien holders who have a lien interest which is subordinate to the NFTL may not receive their share of the proceeds if the sale falls through because the proceeds would not cover an overstated lien payoff amount. We did not interview taxpayers to determine the actual effect the overstatement had on the cases in our sample.

Finally, by including tax periods that are not part of an NFTL, the IRS is implying that those tax periods must be paid before the IRS will release the NFTL on file. This practice could be considered an implied demand for payment of delinquent tax liabilities and denies taxpayers appeal rights afforded by the I.R.C.[11]

Some lien payoff letters understated the amount needed to release liens

There were 11 of 732 lien payoff letters (2 percent) in our sample that were understated by a total of approximately $147,500. Providing understated lien payoff amounts could result in the improper release of an NFTL and cause the government to lose its priority position.

In addition, if a taxpayer, escrow agent, or title company pays the amount listed on an understated lien payoff letter, the IRS may not release the NFTL because the liability has not been fully paid. If this occurs, taxpayers would have to contact the IRS again to find out the proper amount needed to release the NFTL. This could delay the sale of the property and cause additional burden for taxpayers.

[11] I.R.C. § 6330 (2001).

In the case of the 11 taxpayer accounts noted above, there did not appear to be any harm to the government's interest in collecting the taxes owed. Five of the accounts had been fully paid and the liens were released (indicating the third party provided the full amount to satisfy the liability and not just the understated amount on the lien payoff letter). The six remaining understated letters still had liens for the tax periods on the taxpayer's property (indicating either the sale did not go through or the IRS informed the third party that an additional amount was needed to release the NFTL).

We could not determine why these understatements occurred because many of the files we reviewed were incomplete and did not show how the balances were calculated on the lien payoff letters. It is likely that these errors occurred because IRS employees made mathematical errors when calculating the balances and supervisors did not verify employee computations before approving the letters.

Recommendations

1. The Commissioner, Small Business/Self-Employed Division, should develop comprehensive procedures for processing lien payoff letters. These procedures should be incorporated into the IRM. At a minimum, these procedures should include the following:

    - The procedures provided in the memorandum dated August 21, 2001 (Interim Guidance on Disclosure of Lien Balance Due Information), which require employees to obtain and document authorization from the taxpayer before issuing a lien payoff letter to an escrow agent, title company, or any other third party.

    - A requirement for case files to include copies of all NFTLs and calculations showing how the lien payoff amounts were determined. Employees should ensure calculations include the correct interest and penalty accruals and that there are no math errors. This will also be helpful for managers in their review and approval of lien payoff letter balances.

- A nationally standardized lien payoff letter that provides for specific tax periods and related balances to be listed. The letter should specify the taxpayer's name, identification number, tax periods, and amounts that are secured by an NFTL, as well as the county in which the lien was filed. The liability shown on the lien payoff letter should be the amount needed to release the NFTLs.
- A requirement for IRS managers to ensure that all tax periods listed on the standardized letter have appropriate NFTLs and the taxpayer has authorized the release of the information if it is being sent to a third party before approving lien payoff letters.
- Requirements for retaining lien payoff letters for at least 1 year after the end of the processing year.

Management's Response: IRS management agreed and plans on revising the IRM, keeping in the case file a copy of any lien included in the payoff letter, developing a standard lien payoff letter, and reminding employees of retention requirements.

Office of Audit Comment: IRS management's response stated that the report does not distinguish between lien payoff requests that require taxpayer authorization and those specified in the I.R.C.[12] as "parties of interest." We are aware that taxpayers are not required to authorize the disclosure of a lien payoff balance if a "party of interest" (e.g., lender or mortgage holder) contacts the IRS. We did consider this during our review, and our audit results included only those requests from third parties that did require authorization from the taxpayer. We discussed our methodology and the overall audit results with IRS management during this review.

2. Small Business/Self-Employed management should track lien payoff letter requests on a national inventory system to control the cases as well as ensure compliance with case retention requirements. This would also assist management's ability to monitor and promote efficient

[12] I.R.C. § 6103 (k)(2) (2001).

case processing, identify and control information that is being provided to third parties and taxpayers, and comply with the law.

Management's Response: The IRS agreed to include this recommendation in its requests for future enhancements of the Automated Lien System.[13]

[13] The IRS database that stores information on NFTLs.

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine if the Internal Revenue Service's (IRS) lien payoff letters listed the proper amount needed to release the Notice of Federal Tax Lien (NFTL) and if the IRS had authorization from taxpayers before providing the lien payoff letters to third parties (title companies and escrow agents). To achieve these objectives, we performed the following tests:

I. Determined if the IRS could legally disclose lien payoff balances to third parties (title and mortgage companies) for tax periods not covered by an NFTL when a taxpayer sells real property.

   A. Reviewed national procedures in the Internal Revenue Manual addressing Federal Tax Liens and disclosures to third parties.

   B. Reviewed the Internal Revenue Code (I.R.C.) regarding Federal Tax Liens, specifically I.R.C. § 6321 (2001) and § 6323 (2001). I.R.C. § 6321 describes the origination of a Federal Tax Lien, and I.R.C. § 6323 describes the priority of the Federal Tax Lien against other creditors.

   C. Reviewed the pertinent disclosure laws in I.R.C. § 6103 (2001).

II. Determined if the amounts collected from title companies were from periods not covered by an NFTL.

   A. Interviewed IRS management and employees at five judgmentally selected area offices across the nation (Atlanta, Dallas, Los Angeles, Pittsburgh, and Seattle) to determine how lien payoff letters are processed.

      1. Determined the systems used to research the existence of an NFTL.

      2. Determined how payoff amounts were calculated.

      3. Determined if employees followed national or local procedures when preparing lien payoff letters.

      4. Determined if area offices followed disclosure guidelines when giving payoff information to third parties (title companies) by obtaining proper authorizations from taxpayers, if necessary (i.e., Tax Information Authorization (Form 8821)).

   B. Determined if the IRS' lien payoff letters complied with the disclosure provisions in I.R.C. § 6103.

      1. Determined if the National Headquarters developed a standard letter for lien payoffs.

2. Compared the lien payoff letters used by area offices for consistency.
3. Determined if the language used on the lien payoff letters complied with the requirements for a release of the NFTL.[1]

C. Conducted fieldwork at the five IRS offices. Determined the population of lien payoff letters at each area office in order to pull a random sample of letters to review. We reviewed a total of 1,196 lien payoff letters. This included all of the lien payoff letters in 2 sites because of the low number of lien payoff letters retained and samples of lien payoff letters at the other 3 sites based on a 95 percent confidence level, 4 percent precision level, and the error rate determined from a preliminary sample. The chart below shows the number of lien payoff letters sampled and reviewed by site:

Lien Payoff Letters Sampled and Reviewed for Third Party Requests

(1) IRS Site	(2) Population of Lien Payoff Letters in the Office	(3) Lien Payoff Letters Reviewed (of column 2)	(4) Letters Involving Third Parties (of column 3)	(5) Percent of Letters Involving Third Parties (column 4/3)	(6) TIGTA Reviewed Letters During Week of
Site 1	1,267	299	93	31%	10/22/01
Site 2	151	151	100	66%	10/01/01
Site 3	1,034	219	206	94%	10/22/01
Site 4	229	229	177	77%	10/22/01
Site 5	695	298	156	52%	10/08/01
TOTALS	***3,376***	***1,196***	***732***	***61%***	

For each lien payoff letter, we performed the following tests:

1. Secured a copy of the NFTLs from the file.
2. Determined if the IRS requested the proper amount for a release of the NFTL.
3. Determined if the taxpayer authorized the IRS to disclose his or her tax balance to a third party.

[1] I.R.C. § 6325(a) (2001) – Release of Lien or Discharge of Property.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner N:C
Director, Compliance, Small Business/Self-Employed Division S:C
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Audit Liaison:
    Director, Compliance, Small Business/Self-Employed Division S:C

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Privacy – Potential; in 517 cases, there was no documentation that taxpayers authorized the release of their lien payoff balance to third parties (see page 2).

Methodology Used to Measure the Reported Benefit:

At 5 Internal Revenue Service (IRS) sites, we reviewed a total of 1,196 lien payoff letters. This included all of the lien payoff letters in 2 sites because of the low number of lien payoff letters retained and samples of lien payoff letters at the other 3 sites based on a 95 percent confidence level, 4 percent precision level, and the error rate determined from a preliminary sample.

We determined that 732 of the 1,196 lien payoff letters that we sampled involved letters sent to third parties. We reviewed the 732 cases to determine if the taxpayer authorized the IRS to provide the lien payoff balance to a third party. For those lien payoff letters issued to third parties, we determined if the IRS obtained written or verbal authorization from the taxpayer to release the lien payoff balance. We reviewed the case file for Tax Information Authorization (Form 8821), or a similar document, or evidence the taxpayer gave verbal authorization.

Although we used a statistically valid method to select our samples, we did not project our results to each site due to the wide variance in the time period that individual IRS sites retain records.[1] In addition, since the IRS does not track the number of lien payoff letters it processes, it was not possible to estimate the scope of the problem nationwide.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 118 taxpayers received incorrect lien payoff letters that overstated the amount needed to release the Notice of Federal Tax Lien (NFTL) by approximately $1.5 million (see page 5).

[1] There are no national procedures that specifically address how long lien payoff letters should be maintained in the files. IRS officials in the locations we reviewed informed us the retention period ranged from 6 to 12 months; however, when we visited certain offices, we did not always find that records had been retained as indicated.

Methodology Used to Measure the Reported Benefit:

We reviewed the 732 lien payoff letters sent to third parties to determine if the amount shown on the letter would release the NFTL. We used the Automated Lien System[2] to verify the tax periods listed on the NFTL and then used the Integrated Data Retrieval System[3] to calculate the amount owed for each tax period. We compared the balance shown on the lien payoff letters to the balance owed on tax periods that were part of an NFTL. If the IRS included balances from tax periods that were not part of an NFTL on the lien payoff letter, we considered those letters to be overstated.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 11 taxpayers received incorrect lien payoff letters that understated the amount needed to release an NFTL by approximately $147,500 (see page 5).

Methodology Used to Measure the Reported Benefit:

We reviewed the 732 lien payoff letters sent to third parties to determine if the amount shown would result in a release of the NFTL as described above. If the balance shown on the lien payoff letter would not fully pay the NFTL, we considered these to be instances of understated lien payoff letters. In addition, if a taxpayer, escrow agent, or title company pays the amount listed on an understated lien payoff letter, the IRS may not release the NFTL because the liability has not been fully paid. If this occurs, taxpayers would have to contact the IRS again to find out the proper amount needed to release the NFTL. This could delay the sale of the property and cause additional burden for taxpayers.

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[2] The IRS computer system that contains all recorded NFTLs and those Federal Tax Liens that have been released.

[3] The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

LL BUSINESS/SELF-EMPLOYED DIVISION

MAY 23 2002

RECEIVED
MAY 23 2002

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Better Procedures are Needed to Ensure Lien Payoff Letters are Properly Authorized and Accurately Calculated (Audit # 200110041).

We reviewed your report and agree with your recommendations. We will use them to improve our procedures for handling correctly our responses for lien payoff requests.

Your report does not distinguish between lien payoff requests that require taxpayer authorization and those specified in section 6103(k)(2) of the Internal Revenue Code to "parties of interest." Disclosures to parties who have a right to the property in question or intend to acquire such right do not require taxpayer authorization. Documentation in the form of a copy of contract of sale or loan application is sufficient evidence of intent. These opinions are based on advice from our Counsel.

We agree disclosures to other third parties, such as escrow or title companies acting as agents for the purchaser or lender, require taxpayer authorization.

The potential benefits stated in Appendix IV appear correct based on your sample. We agree ensuring we provide the correct lien payoff amount would reduce taxpayer burden, however we cannot track this measure and we will not measure it in the future.

Our responses to your recommendations follow.

RECOMMENDATION 1
The Commissioner, Small Business/Self-Employed Division, should develop comprehensive procedures for processing lien payoff letters. These procedures should be incorporated into the IRM. At a minimum, these procedures should include the following:

- The memorandum dated August 21, 2001, (Interim Guidance on Disclosure of Lien Balance Due Information) requires employees to obtain and document authorization from the taxpayer before issuing a lien payoff letter to an escrow agent, title company, or any other third party.

- A requirement for case files to include copies of all NFTLs and calculations showing how the lien payoff amounts were determined. Employees should ensure calculations include the correct interest and penalty accruals and that there are no math errors. This will also be helpful for managers in their review and approval of lien payoff letter balances.
- A nationally standardized lien payoff letter that provides for specific tax periods and related balances to be listed. The letter should specify the taxpayer's name, identification number, tax periods, and amounts that are secured by an NFTL, as well as the county in which the lien was filed. The liability shown on the lien payoff letter should be the amount needed to release the NFTLs.
- A requirement for IRS managers to ensure that all tax periods listed on the standardized letter have appropriate NFTLs and the taxpayer has authorized the release of the information if it is being sent to a third party before approving lien payoff letters.
- Requirements for retaining lien payoff letters for at least 1 year after the end of the processing year.

ASSESSMENT OF CAUSE
Our procedural guidelines were not as comprehensive as they needed to be at the time of the audit. This was due, in part, to delays in adding more specific procedures to the Internal Revenue Manual.

CORRECTIVE ACTION
We agree with the recommendation and will take the following corrective actions:

1. We have incorporated the procedures from the August 21, 2001 memorandum, Interim Guidance on Disclosure of Lien Balance Due Information in the Internal Revenue Manual (IRM) revision, which has been cleared for publication.
2. We agree case files should include a copy of any lien included in the payoff letter and the computations of balance due. Files should also include the taxpayer authorization or the documentation for the disclosure under section 6103(k)(2) of the Internal Revenue Code. IRM procedures will be revised accordingly.
3. We will develop a standard lien payoff letter template with instructions for its use within the next six months.
4. We agree we should review the periods listed on the payoff letter to determine compliance with the taxpayer's authorization or the documentation requirements for section 6103(k)(2) of the Internal Revenue Code before we issue the payoff letter. We will revise Internal Revenue Manual procedures within the next six months in conjunction with the development of the national standard template.
5. We will send a memorandum to appropriate staff reminding them of the requirement to maintain case files for one year to comply with the requirements of the IRS correspondence handbook.

IMPLEMENTATION DATE
1. Completed
2. June 1, 2003
3. January 1, 2003
4. January 1, 2003
5. September 1, 2002

RESPONSIBLE OFFICIAL
Director, Filing and Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN
The Program Manager, Technical and Insolvency, will advise the Director, Filing and Payment Compliance, Small Business/Self-Employed Division if the corrective action is delayed.

RECOMMENDATION 2
Small Business/Self-Employed management should track lien payoff letter requests on a national inventory system to control the cases as well as ensure compliance with case retention requirements. This would also assist management's ability to monitor and promote efficient case processing, identify and control information that is being provided to third parties and taxpayers, and comply with the law.

ASSESSMENT OF CAUSE
We do not systemically track Lien Payoff letters.

CORRECTIVE ACTION
We agree to include this recommendation in our requests for future enhancements of the Automated Lien System (ALS). The ALS based option, including the letter template noted above, is the only practical means of implementing this recommendation.

IMPLEMENTATION DATE
June 1, 2003

RESPONSIBLE OFFICIALS
Director, Filing and Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN
The appropriate Program Managers, will advise the Director, Filing and Payment Compliance, Small Business/Self-Employed Division of any delays.

Please call Joseph R. Brimacombe, Director, Compliance Policy, Small Business/Self-Employed, at (202) 283-2150 if you have any questions.